



COUNCIL AGENDA: 4-8-14  
ITEM: 3.7

## Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Toni J. Taber, CMC  
City Clerk

**SUBJECT:** SEE BELOW

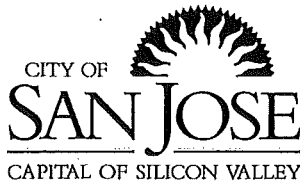
**DATE:** 3-27-2014

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**SUBJECT: RETIREMENT BOARD GOVERNANCE REFORM BALLOT MEASURE  
WORKPLAN**

### RECOMMENDATION

As recommended by the Rules and Open Government Committee on March 19, 2014 and outlined in the attached memo previously submitted by the Rules and Open Government Committee, accept the Retirement Board Governance Reform Ballot Measure Workplan.



# Memorandum

**TO:** RULES AND OPEN GOVERNMENT  
COMMITTEE

**FROM:** Alex Gurza

**SUBJECT: RETIREMENT BOARD  
GOVERNANCE REFORM  
BALLOT MEASURE WORKPLAN**

**DATE:** March 12, 2014

Approved

Date 3/13/14

## RECOMMENDATION

Accept the Retirement Board Governance Reform Ballot Measure Workplan.

## BACKGROUND

As the Rules Committee is aware, Cortex Applied Research, Inc. conducted a governance review of the Federated City Employees' Retirement System and Police and Fire Department Retirement Plan Boards of Administration. This report provided fifteen recommendations to enhance the current governance structure of the Boards:

Recommendations contained in Cortex's report would require changes to various sections of the City Charter, including but not limited to City Charter Section 701, as the City Manager appoints all officers and employees of the City, except as provided otherwise in the City Charter. Cortex's recommendation to grant full autonomy to the Boards to appoint, direct, terminate and evaluate Retirement Services staff could be implemented through amendments to the City Charter to expressly grant this authority to the retirement boards in addition to other provisions that would be modified by granting autonomy to the boards. The other recommendations contained in Cortex's report would be reviewed to determine the other sections of the City Charter that would have to be amended.

This issue was last heard at the March 4, 2014, City Council meeting, during which, the City Administration was directed to bring back to the Rules Committee a workplan for the critical dates and timelines necessary to complete a retirement board governance ballot measure. We have attached the Council memo that was discussed at the March 4th Council meeting which contains further background on this topic as well as the workplan the Rules Committee approved on January 22, 2014.

## **BALLOT MEASURE DEADLINES**

The timeline below outlines the process for the City Council to approve a ballot measure:

<b>Ballot Measure Deadlines</b>	
<b>Action</b>	<b>November Election Deadlines</b>
Ballot Measure Workplan to Rules Committee	3/19/2014
Last scheduled City Council meeting prior to 88 days before election	6/17/2014
Potential City Council meeting prior to 88 days before election (not currently scheduled)	8/5/2014
88 days before election	8/8/2014

Currently, June 17, 2014 is the last scheduled Council meeting prior to 88 days before the November election. If the August 5, 2014, potential Council meeting date is not added, it is unlikely that staff would have sufficient time to take the ballot measure to Council for approval.

## **BALLOT MEASURE WORKPLAN TIMELINES**

The other key action items that would need to occur before a ballot measure could proceed, in order of implementation with estimated timeframes, are:

1. Council consideration of ballot measure and direction to staff (1 Council meeting)
2. Determine possible meet and confer issues and commence meetings (90 days)
3. Stakeholder outreach (90 days)
4. Draft ballot measure language (30-60 days)

In order to provide adequate time to prepare for a ballot measure, Council would need to provide direction to the City Administration by the middle of April 2014 to account for the work that need to be accomplished in time for a November election.

Using the key action items mentioned above, the approximate timelines for the November election include:

<b>Ballot Measure Workplan Timelines</b>	
<b>Action</b>	<b>November Election Timelines</b>
Council meeting to direction on ballot measure and provide direction to staff	Mid-April 2014
Discussions with bargaining units	April – June 2014
Stakeholder outreach	April – June 2014
Draft ballot measure language	June – July 2014

RULES AND OPEN GOVERNMENT COMMITTEE

March 12, 2014

**Subject: RETIREMENT BOARD GOVERNANCE REFORM BALLOT MEASURE WORKPLAN**

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It is important to note that the date ranges in the timeline may either be shorter or longer than the approximate time ranges listed above.

**CONCLUSION**

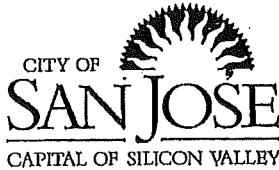
Due to the limited timeframe necessary to complete the key items before a potential August 5, 2014 Council meeting, we will need further Council direction as soon as possible.



Alex Gurza  
Deputy City Manager

For questions, please contact Alex Gurza, Deputy City Manager, at (408) 535-8155.

Attachments



## Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Alex Gurza

**SUBJECT:** DISCUSSION AND DIRECTION  
TO STAFF REGARDING  
RETIREMENT BOARD GOVERNANCE

**DATE:** February 21, 2014

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Approved /s/ Ed Shikada

Date 2/21/14

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### RECOMMENDATION

Direct staff to evaluate policy alternatives to accomplish retirement board governance changes without a ballot measure.

### OUTCOME

If the City Council approves the recommendation, the City Administration will in coordination with the City Attorney's Office, explore ways to accomplish the retirement board governance changes without a ballot measure. This review will include any outstanding legal, personnel and other questions that have not been specified by Cortex's recommendations. The Administration will bring this issue back to Council once we conduct further research.

### BACKGROUND

#### PHASE I

In 2009, the City contracted with Cortex Applied Research, Inc to review the fiduciary governance models of the City's two retirement plans, the Federated City Employees' Retirement System Board and the Police and Fire Department Retirement Plan Board. Cortex's review identified several recommendations to enhance to experience and expertise of retirement board members and to ensure that the retirement boards are free of significant conflicts of interest. The City implemented all but six (6) of Cheiron's recommendations as Phase I. The other recommendations to improve Board governance were to be brought back to Council at a later date under Phase II.

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**PHASE II**

During the November 19, 2013, City Council meeting, Cortex Applied Research presented fifteen (15) recommendations to the City Council as part of their updated report on the governance structures of the City's two retirement boards. These fifteen (15) recommendations were based on the following categories: authority of the retirement board, safeguards for stakeholders, transparency and disclosure, risk oversight, and scale and efficiency. A summary of these recommendations can be found below. The Council directed the City Administration to develop a workplan to implement Cortex's recommendations.

Expand the Authority of the Boards	Independence of the Boards, including the ability to: <ul style="list-style-type: none"><li>• Appoint, direct, evaluate and terminate staff</li><li>• Set compensation levels and determine human resources policies</li><li>• Appoint legal counsel</li><li>• Establish procurement policies</li></ul>
Establish Additional Safeguards for Stakeholders	All Board members selected by the City should be independent
	75% of the Board's composition should be independent
	Role of the Board's should be clearly defined in statute to exclude advocating or taking positions on legislative actions that affect the benefits provided by Retirement Services
	Discourage the Boards from engaging in economically targeted investing
	Staff serving the Retirement Boards should not be entitled to receive benefits from either System
Transparency and Disclosure	Any independent Board member appointed by the City or active/retired members should have expertise and experience relevant to the administration of the Retirement Systems.
	Ability to offer appropriate compensation to independent board members (approximately \$20,000)
	Provide additional annual disclosures i.e. annual compensation for senior executives and independent report on the cost-effectiveness of the Systems
	Eliminate non-voting Board member
Sanctions	Hold an annual general meeting that is accessible to the public
	Enact provisions that allow for the removal of any Board member for their performance or conduct by appointing authorities
Risk Oversight	Conduct an external independent review of the Boards' fiduciary and management once every 5 years
	Establish an audit committee
Scale and Efficiency	Pursue consolidation of the two Systems under the oversight of one retirement board.

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Cortex has recently provided an addendum to their final report to specify which of the recommendations they believe to be primary recommendations. These recommendations are intended to be implemented concurrently (Please see Attachment 1.) These three (3) recommendations are greater board autonomy, 25% of each Board should consist of independent trustees appointed by active and retired plan members, and any independent board member appointed by the City of actives/retirees should have relevant expertise and experience in the administration of retirement systems. The addendum further clarified the first recommendation as Cortex's intent was for the employees of the retirement systems to report to the retirement boards and be exempt from City Civil Service Rules. Cortex viewed the other twelve (12) recommendations as secondary as they were not necessary to implement in the proposed governance model or that the recommendations had already been put in place by Phase 1.

At the January 22, 2014, Rules Committee meeting, the City was directed to work with the City Attorney's Office to provide policy alternatives for the implementation of the recommendations for the retirement board governance based on the recommendation and workplan provided by the Administration (Please refer to Attachment 2.)

**ANALYSIS**

There are different options to accomplish the recommendations contained in Cortex's report which are outlined below. The policy alternatives are in response primarily to Cortex's first recommendation: granting full autonomy to the Boards. Legal issues, personnel issues and cost implications are examples of the different issues to consider when deciding upon which alternative to further explore.

**Policy Alternative #1- Ballot Measure**

The recommendations described above would require changes to various sections of the City Charter, including but not limited to City Charter Section 701, as the City Manager appoints all officers and employees of the City, except as provided otherwise in the City Charter. Cortex's recommendation to grant full autonomy to the Boards to appoint, direct, terminate and evaluate Retirement Services staff could be implemented through amendments to the City Charter to expressly grant this authority to the retirement boards in addition to other provisions that would be modified by granting autonomy to the boards. The other recommendations contained in Cortex's report would be reviewed to determine the other sections of the City Charter that would have to be amended.

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Although Cortex has made specific recommendations, including granting full autonomy to the Board, many details of the implementation of a ballot measure have yet to be determined. For example, the Cortex report does not provide a set level of compensation that would be appropriate for the executive management staff of retirement services. Since salaries of retirement staff are paid out of plan assets, it is difficult to assess the cost implications.

In Cortex's addendum to their initial report, Cortex stated that the intention of the recommendation is to make the Department of Retirement Services staff employees of the retirement system as opposed to employees of the City, and not members of the City's retirement system. Therefore, the employees would report to the retirement boards, be exempt from City Civil Service Rules, and not be members of the City's retirement system, which raises other issues that would need to be considered.

**Ballot Measure Timelines**

The timeline below outlines the process for the City Council to approve a ballot measure for the November election. As was discussed at the Rules Committee meeting on January 22, 2014, there is no possibility of meeting a June election timeframe given the significant stakeholder outreach and other analysis that would need to be completed.

Ballot Measure Deadlines	
Action	November Election Deadlines
Workplan to Rules Committee	1/22/2014
Last City Council meeting prior to 88 days before election	6/17/2014
88 days before election	8/5/2014

If the ballot measure alternative is chosen, the Council should consider placing the ballot on the November election after all alternatives have been explored.

***Key Benefits***

- Stakeholder approval: The ballot measure would ensure key stakeholder approval by putting Cortex's recommendations to a public vote.
- Improved retirement board governance: If this model is chosen, the governance structure as articulated in the ballot measure would satisfy Cortex's recommendations.

***Key Issues***

- Cost implications: A ballot measure can cost upwards of \$600,000 and the funding source for the ballot measure has not yet been considered.
- Staffing impact: Retirement Services is currently comprised of 36.5 FTE positions for Fiscal Year 2013-2014. If the ballot measure is approved, these positions would potentially be eliminated. This may be subject to the meet and confer process and could potentially result in layoffs and/or bumping.



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- Timeline: The accelerated timeline for the June 2014 ballot measure would be a challenge due to the time necessary for stakeholder outreach and ballot measure language approval. The November 2014 election timeline appears to also be a challenge when giving consideration to the specifics of the ballot measure that have yet to be determined.
- Subsequent Ballot Measure: If changes to the governance structure are necessary after voters have approved the ballot measure altering the City Charter, any further modifications would need to be brought back to the voters. This could be a prohibitive and time-consuming process for changes that may need to be made quickly if any issues arise.

*Policy Alternative #2 – Ways to accomplish Cortex's recommendations without a ballot measure*

Due to the rigorous and lengthy process that is required to bring changes to the City's Charter to the voters via a ballot measure, another opportunity that may accomplish Cortex's recommendations, including full autonomy to hire and terminate staff, would be to explore a hybrid business model similar to the Team San Jose and work2future organizational approaches. These business models need further review into the legal issues associated with them.

As background to the Team San Jose structure, in March 2003, the Mayor's Budget Message directed the City Administration to save costs and improve efficiencies at the Convention Center by revising the operating structure. At that time, the Conventions, Arts, and Entertainment Department oversaw the operations and management of the San Jose Convention Center. Team San Jose (TSJ), a not-for-profit public benefit corporation, was chosen to manage and operate the Convention center and Cultural Facilities.

The City entered into a Management Agreement with Team San Jose. The provisions of this contract included:

- Compensation
- Key Business Terms and Conditions
- Termination Provisions
- Operating and Capital Budgets
- Audits (including an annual performance audit)
- Financial Procedures
- Personnel

The Management Agreement provided that TSJ would hire, retain, discipline, and supervise the permanent full-time employees that were employed by the City. These employees were termed "Shared Employees." In addition, the City negotiated a memorandum of understanding for the use of City employees by TSJ that included hiring practices and performance evaluations for the shared employees. The employees were retained by TSJ, but continued to be City employees. TSJ was also able to hire their own employees that were not City employees. It should be noted that TSJ has transitioned from this model and no longer has any City employees retained by TSJ.

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As background on the work2future model, work2future has recently revised their business model to direct client services through a third-party administrator (TPA). In 2011, the work2future Board of Directors created the 501(c)(3) work2future Foundation. The work2future Foundation was selected as the TPA through a unique services agreement to provide the services that gave the work2future Foundation the ability to hire their own staff, while retaining a reduced number of City employees.

The TSJ and work2future models need to be further explored to decide if this policy alternative would be beneficial to the City and the retirement systems. Due to the unknown legal implications of an alternative operations model, the City Administration will work closely with the City Attorney's Office on the evaluation of this option.

*Key Benefits*

- Cost-savings: The City would not have to fund a ballot measure, and instead the cost implications would only be a result of any staffing impacts.
- Ability to audit services: As is currently the case with Team San Jose, the City Auditor's office would be able to perform an audit of the agreed upon performance measures on a regular basis to ensure that specific requirements are being met.
- Timeline: Without the need to conform to the ballot measure timeline, the process for implementing a management agreement could have a non-restricted timeline to vet any outstanding issues and concerns.
- Improved operations and governance: The TSJ model, as it is right now does not have any City employees currently working for TSJ; as they are all employees of TSJ. If this model is chosen, the operating structure may satisfy Cortex's recommendation that retirement staff report to the retirement boards.
- Flexibility: If issues arise with the initial management agreement with a new retirement services entity, the agreement can be modified through Council action. This would be an important detail if any time-sensitive changes need to be made.

*Key Issues*

- Legal Implications: The City would need to continue exploring the alternative business model approach to determine any legal issue that may arise while pursuing this option.
- Staffing impact: Retirement Services is currently comprised of 36.5 FTE positions for Fiscal Year 2013-2014. If the TSJ or work2future model is approved, some or all of these positions would potentially be eliminated. This may be subject to the meet and confer process and could potentially result in layoffs and/or bumping.

*Policy Alternative #3 – Continue current governance structure*

Under this alternative, the current governance structure of the City's Department of Retirement Services and two retirement boards would continue. The retirement boards have been working to implement several of Cortex's secondary recommendations that improve the risk and oversight of the plan. In addition, the Municipal Code has recently been amended to include the retirement boards in the decision making process as it relates to executive personnel matters for Department

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of Retirement Services Staff. The current model could continue for to allow for additional time to fully understand the impacts of these previous actions.

*Key Benefits*

- Maintain internal control: The City Council would retain more oversight into the operations of Retirement Services.

*Key Issues*

- Without implementing Cortex's recommendations through one of the above alternatives, the retirement systems would continue to operate with only partial authority and remaining lacking in safeguards for the retirement systems.

It is important to note that a key issue that will need to be explored in all alternatives is what areas are subject to the meet and confer process, especially as it relates to there no longer being any City employees in the Department of Retirement Services.

**EVALUATION AND FOLLOW-UP**

If the Council approves the recommendation, the City Administration will work with the City Attorney's Office and the two retirement boards to explore Policy Alternative #2. Further consideration will be given to the legal, personnel and other issues that may arise with Policy Alternative #2.

After the analysis has been conducted, the Administration will bring forward the results to the Council for their consideration.

**PUBLIC OUTREACH/INTEREST**

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to \$1,000,000 or greater. (Required: Website Posting)
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. (Required: E-mail and Website Posting)
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. (Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)

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This memo will be posted on the City's website for the March 4, 2014 Council meeting. The policy alternative chosen to implement the recommendations will determine the extent of any other required public outreach. The ballot measure alternative will require stakeholder outreach for the bargaining units, retirees, active City employees, and the general public.

We anticipate that ninety (90) days will be needed to complete the stakeholder outreach due to the complexity of the issue and number of stakeholders. The City Administration will work to advertise the stakeholders meetings to the requisite groups. The general public will be notified through emails to local businesses and neighborhood associations. Distribution of the stakeholder outreach meeting information will be communicated through email with an attached flyer noting the location and time of each meeting.

**COORDINATION**

This memo has been coordinated with the City Attorney's Office.

**COST SUMMARY/IMPLICATIONS**

*Policy Alternative #1- Ballot Measure*

Taking an issue to the ballot may result in substantial costs to the City depending on the number of items already appearing on the ballot. In conjunction with the City Clerk, the preliminary cost estimates for the June and November election can be found below:

Ballot Measure	June Election	November Election
Cost Estimate	Approximately \$425,000 - \$1,000,000	Approximately \$425,000- \$637,500

The funding source(s) for the ballot measure still need to be determined.

The costs to absorb classified City employees who will not be retained through the changes made in the ballot measure. This will be one of the areas that the Administration will explore further.

*Policy Alternative #2 - Ways to accomplish Cortex's recommendations without a ballot measure*

The costs to absorb classified City employees who would not be retained by the new operating structure. This will be one of the areas that the Administration will explore further.

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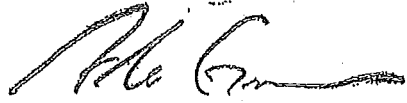
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CEQA

Not a Project, File PP10-069(a), City Organizational & Administrative Activities.

A handwritten signature in black ink, appearing to read 'Alex Gurza', with a stylized flourish at the end.

Alex Gurza  
Deputy City Manager

For more information, please contact Alex Gurza at (408) 535-8155.

Attachments

January 29, 2014.

**REVIEW OF THE GOVERNANCE MODELS OF POLICE AND FIRE DEPARTMENT RETIREMENT PLAN  
AND FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM**

**ADDENDUM**

Subsequent to issuing our draft report entitled *Review of the Governance Models of Police and Fire Department Retirement Plan and Federated City Employees' Retirement System* dated May 9, 2013 (the "Report"), Cortex followed up with various stakeholders to obtain comments and feedback. Based on these follow up discussions, it was apparent that some confusion existed concerning our report and recommendations. Accordingly, Cortex has prepared this addendum to clarify various aspects of the Report. Specifically, this addendum attempts to clarify:

- Our proposed governance model.
- Our recommendations for implementing the proposed governance model.
- The extent to which our recommendations were intended to be implemented concurrently as a package.
- The implications the recent Measure B judicial decision may have for our recommendations.<sup>1</sup>

**A. PROPOSED GOVERNANCE MODEL**

Cortex's proposed governance model provides that the governance structure of a public retirement system should meet the following general criteria or principles:

**1. Fiduciary Autonomy**

The governing board of a public retirement system requires full and clear autonomy to administer the retirement system. Without such autonomy, a governing board will not be able to function effectively or efficiently and the performance of the system, both in the investment and member service areas, will suffer. Furthermore, if the authority to administer the system is shared between the governing board and other parties, it will be difficult if not impossible to establish clear accountability for the performance of the system.

**2. Stakeholder Confidence**

As a general principle, the key stakeholders of a public retirement system need to be reasonably confident that the retirement system will be administered effectively, efficiently, and in the best interests of members and beneficiaries, and that the governing board will exercise its

<sup>1</sup> See Santa Clara County Superior Court Judge Patricia Lucas's decision on Measure B filed December 20, 2013.

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autonomy prudently and appropriately. If such confidence does not exist, stakeholders are unlikely to support granting the governing board the necessary degree of autonomy.

### 3. Safeguards and Protection

The best method for promoting confidence among stakeholders is to establish sufficient safeguards and protections that will guard against the inappropriate use of autonomy by the governing boards and that will promote effective administration of the retirement system.

The most important safeguards and protections generally include the following:

- a) There must be appropriate representation of stakeholders on the governing board, i.e. the composition of the governing boards must reflect the key stakeholders of the retirement system.
- b) The governing board must be sufficiently independent so as to be able to engage in objective decision-making on behalf of all members and beneficiaries.
- c) The governing board must be sufficiently qualified to make the complex decisions involved in administering the system and overseeing the advisors and agents of the system.
- d) The operations and decisions of the governing board should be highly transparent to stakeholders and there should be strong mechanisms for communication between the governing board and stakeholders.

In designing *specific* safeguards and protections, the relative risk exposures of the different stakeholders need to be carefully considered. Any stakeholder that bears significantly more risk relative to other stakeholders may be justified in expecting greater protections or safeguards. If risks are borne approximately equally by all stakeholders, then no stakeholder group should expect additional safeguards or protections over and above those provided to the other stakeholder group(s).

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## **B. RECOMMENDATIONS FOR IMPLEMENTING THE PROPOSED GOVERNANCE MODEL**

The above discussion describes the *general* model proposed by Cortex. In the Report, Cortex also identifies 15 recommendations for implementing the proposed model.<sup>2</sup> Below, we attempt to clarify each recommendation, confirm which recommendations are of primary importance, and which recommendations should be implemented concurrently.

### ***Primary Recommendations***

The following three recommendations are of primary importance and should be implemented concurrently:

1. The authority of the two San Jose retirement boards should be expanded to include among other things the authority to hire, direct, evaluate, and terminate their own staff; to set necessary compensation levels to attract and retain staff; and to directly appoint independent legal counsel.<sup>3</sup>

For greater clarity, in making the above recommendation, Cortex intended that the retirement staff should be employees of the retirement systems rather than of the City, that they should report to the retirement boards rather than to the City Manager, and that they should be exempt from City civil service rules.

2. The proportion of each City Retirement Board that must consist of active or retired members should be reduced to approximately 25%. Furthermore, approximately 25% of each Board should consist of independent persons appointed by active and retired plan members.<sup>4</sup>

For greater clarity our recommendation originally intended that:

- a) The City and the members/retirees be equally represented on each Retirement Board.<sup>5</sup>
- b) Plan members and retirees would have the ability to directly appoint those board members they selected, as opposed to the current structure in which members and retirees may only nominate to City Council the individuals they wish to represent them on the boards.

Due to the judicial decision concerning Measure B, however, these two elements of our recommendation were re-examined. (See Section C of this Addendum for details.)

3. Any Independent board member appointed to the Board by City Council or by active/retired members should be required to have relevant expertise and experience relevant to the administration of the Retirement Systems.<sup>6</sup> This recommendation would result in approximately 75% of the members on each retirement board being required to have

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<sup>2</sup> For purposes of this Addendum we ignore Recommendation 2 on page 24 of the Report (i.e. that City representatives should be independent of the City); as it has already been implemented by the City.

<sup>3</sup> See Recommendation 1 on page 23 of the Report.

<sup>4</sup> See Recommendation 3 on page 24 of the Report.

<sup>5</sup> See the final paragraph of Recommendation 3, on page 25 of the Report.

<sup>6</sup> See Recommendation 7 starting on page 25 of the Report.



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relevant expertise (currently just over 50% of each board is required to have relevant expertise).

Cortex believes the above recommendations are closely connected and should therefore be implemented concurrently. Our reasoning is as follows:

- Stakeholders will likely not be confident enough in the governance of the Systems to support granting full autonomy to the governing boards, unless reasonable minimum safeguards and protections exist, namely the following:
  - a) The boards are sufficiently independent.
  - b) The boards are sufficiently qualified.
  - c) There is sufficient stakeholder representation on the boards.
- On the other hand, adding the above safeguards and protections without also granting the governing boards full autonomy will lead to dissatisfaction and frustration among the board members and will not lead to improved investment performance or member service quality.

The above recommendations (i.e. that approximately 75% of each board should consist of independent and qualified board members) reflect Cortex's views as to what constitute reasonable and appropriate safeguards to support board autonomy, and are based on Cortex's experience and research. Cortex recognizes however that stakeholders may have different risk tolerance levels and may demand stronger or weaker safeguards (i.e., a lesser or greater number of independent and qualified board members). Accordingly, it may be beneficial for the City and the members/retirees to discuss the above recommendations to determine the precise parameters that will provide the necessary degree of stakeholder confidence in San Jose.

Please see Table I for an overview of the composition of each board based on Cortex's recommendations.

### **Secondary Recommendations**

While worthy of consideration, Cortex considers the other 11 recommendations in the Report to be of secondary importance and does not view them as absolutely necessary for implementing our proposed governance model. Below we summarize the reasons why:

- a) Recommendation 4 in the Report (page 25) states the role of the Retirement Boards should be clearly defined in statute to exclude advocating for, or taking positions on, legislative changes affecting the nature or cost of the benefits provided by the Retirement Systems. This recommendation is not necessary to implement our governance model, as legislation already exists that limits boards from engaging in inappropriate political activities.
- b) Recommendation 5 in the Report (page 25) states that governing legislation should discourage the Retirement Systems from engaging in economically targeted investing, and should prohibit the City from promoting such investments to the Retirement Systems. We

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recognize however that laws already exist to discourage pension fund fiduciaries from pursuing economically targeted investment strategies. We nevertheless included this recommendation in response to concerns raised by members and retirees during past outreach discussions.

- c) Recommendation 6 in the Report (page 25) states that the staff serving the Retirement Boards should be independent in that they should not be entitled to receive benefits from either of the City Retirement Systems. While we believe this is desirable, we recognize it may be difficult to implement and that a new benefit program may not be as cost-effective as the current program.
- d) Recommendation 8 in the Report (page 26) states essentially that independent board members should be provided higher levels of compensation reflecting the amount of time, effort, and risk involved in the position. While we have classified this as a secondary recommendation, Cortex strongly recommends that it be adopted, as it is intended to facilitate the implementation of two primary recommendations (i.e. it will support the recruitment and retention of qualified and independent board members.).
- e) Recommendations 9, 10, 11, 13, and 14 in the Report (page 26-28) contain numerous recommendations intended to either increase transparency in the operations of the board and the systems, or enhance communications between the boards and the stakeholders. For retirement systems in certain other jurisdictions, these recommendations might potentially be very important. Given, however, that the San Jose retirement systems are already very transparent, and that there is ample opportunity for communication among stakeholders and the boards, Cortex believes these recommendations are of secondary importance.
- f) Recommendation 12 in the Report (page 27) states that provisions should be established in legislation to allow for the removal, by the appropriate appointing authority, of any board member for cause. We suspect the ability to remove board members for cause is implicit in the ability to appoint them and we understand if stakeholders may feel this does not need to be formalized.
- g) Finally, recommendation 15 of the Report (page 28) recommends that the City consider enhancing the operational scale and efficiency of the Retirement Systems by pursuing consolidation of the two systems under the oversight of a single retirement board. We have classified this as a secondary recommendation because it is unrelated to our proposed governance model, which is the focus of our analysis; i.e., combining the retirement boards is neither a safeguard nor a protection against granting autonomy to the retirement boards. Instead, it relates to the issues of organizational scale and efficiency.

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As background, it is our understanding that the two retirement boards have reviewed Cortex's secondary recommendations and have already committed to implementing them to the extent

January 29, 2014.

they have the authority to do so.<sup>7</sup> More specifically, the boards have implemented, or are in the process of implementing, recommendations 4, 5, 9, 11, 13, and 14.

To summarize, only Cortex's primary recommendations are intended to be implemented concurrently. Cortex views the remaining recommendations to be worthy of consideration, but not absolutely necessary for implementing the proposed governance model. If however the stakeholders of the San Jose retirement systems determine that the safeguards contained in our primary recommendations are insufficient, they may wish to consider the additional safeguards contained in our secondary recommendations.<sup>8</sup>

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<sup>7</sup> The boards of course do not have the authority to enshrine the recommendations in the City Charter or Municipal Code, as recommended by Cortex. Instead, where possible, the boards have agreed to implement the recommendations using board policy.

<sup>8</sup> Note, Cortex does not consider combining the boards to be safeguards or protections, but rather a possible method of enhancing economies of scale and achieving efficiencies.

January 29, 2014.

### **C) IMPLICATIONS OF MEASURE B DECISION**

The degree to which financial risk is shared among stakeholders has important implications for how our recommended governance model is implemented. As stated above, if one stakeholder bears relatively more risk, then it is reasonable for that stakeholder to expect greater protections or safeguards. If stakeholders bear risk approximately equally, then the governance model can be viewed as a true partnership and no stakeholder should require greater protections or safeguards relative to the other stakeholders.

In the case of San Jose, our understanding of how risk is to be shared among stakeholders has changed over time due to various developments.

When preparing the Report, we assumed that the passage of Measure B implied that the financial risk of the system would, over time, be shared approximately equally between the City and the members/retirees. Accordingly, we recommended in the Report that the City and the members/retirees should be represented equally on the two retirement boards; i.e. the City should select and appoint half of the members of each board and the members/retirees should select and appoint the other half. (The members of each board so appointed could also then select one additional member.)

A recent judicial decision concerning Measure B now suggests however that risk will be shared equally only with respect to new plan members, and that the City will bear the majority of financial risk with respect to current liabilities. This suggests that our recommendations need to be modified somewhat.

Under our proposed model it would be reasonable for the City to expect relatively greater protections or safeguards to compensate for the greater risk it bears. Two reasonable solutions are as follows:

1. Change the balance of power on the boards so that the City selects and appoints a majority of the members of each board; or
2. Maintain equal representation on the two boards, but allow the City to retain the final authority to appoint all board members.

Of the above two options, Cortex recommends the second. We believe that maintaining equal representation on the boards, but having the City maintain final authority over all board appointments, promotes a spirit of partnership in fiduciary decision-making while recognizing the greater risk borne by the City.

We trust the above provides helpful clarification concerning the Report. If any board member or stakeholder has further questions, Cortex would be pleased to discuss them.

January 29, 2014.

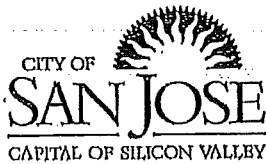
**TABLE I: BOARD COMPOSITION UNDER CORTEX'S RECOMMENDATIONS**

**EXCLUDING 9<sup>TH</sup> AND 7<sup>TH</sup> MEMBERS**

	Police & Fire		Federated	
	Number of Board Members	Percentage of Board (excl. 9 <sup>th</sup> member)	Number of Board Members	Percentage of Board (excl. 7 <sup>th</sup> member)
Independent Board Members Selected by the City	4	50	3	50
Independent Board Members Selected by Members/ Retirees	2	25	1	16.7
Members/Retirees	2	25	2	33.3
<b>Total Board Members (excl. 7<sup>th</sup> &amp; 9<sup>th</sup> members)</b>	<b>8</b>	<b>100</b>	<b>6</b>	<b>100</b>
Board Members representing the City	4	50	3	50
Board Members representing Members/Retirees	4	50	3	50

**INCLUDING 9<sup>TH</sup> AND 7<sup>TH</sup> MEMBERS**

	Police & Fire		Federated	
	Number of Board Members	Percentage of Board (incl. 9 <sup>th</sup> member)	Number of Board Members	Percentage of Board (incl. 7 <sup>th</sup> member)
Independent Board Members Selected by the City	4	44.4	3	42.9
Independent Board Members Selected by Members/ Retirees	2	22.2	1	14.3
Members/Retirees	2	22.2	2	28.6
Independent board member selected jointly by above	1	11.1	1	14.3
<b>Total Board Members</b>	<b>9</b>	<b>100</b>	<b>7</b>	<b>100</b>
Board Members representing the City	4 + ½	50	3 + ½	50
Board Members representing Members/Retirees	4 + ½	50	3 + ½	50



## Memorandum

TO: RULES AND OPEN GOVERNMENT COMMITTEE FROM: Alex Gurza

SUBJECT: RETIREMENT BOARD GOVERNANCE REFORM STRATEGIC WORKPLAN DATE: January 16, 2014

Approved

Date

1/17/14

### RECOMMENDATION

1. Acceptance of the Retirement Board Governance Reform Strategic Workplan.
2. Direct the City Manager staff to work with the City Attorney's Office to provide policy alternatives for the City Council.

### BACKGROUND

At the November 19, 2013, Council meeting, Cortex Applied Research, Inc., presented their fifteen (15) recommendations to the City Council as part of their report on the governance structures of the City's two retirement boards, the Federated City Employees' Retirement System Board and the Police and Fire Department Retirement Plan Board. The recommendations were based on the following categories: authority of the retirement boards, safeguards for stakeholders, transparency and disclosure, risk oversight and scale and efficiency. During this meeting, Councilmember Constant made the following motion that was approved unanimously by the Council:

*"I'd like to make a motion that we refer to the City Attorney and the City Manager to work towards developing a recommendation to implement the changes contemplated in the Cortex report as a package including -- including working with outside counsel on that, to return to rules committee with a work plan that -- of the items that are necessary to accomplish, which includes the stakeholder outreach, to have a final product on a council agenda in time for either the June or the November election in 2014, and to ask that each of the boards weigh-in on the issue of whether they support the Cortex recommendations as a package, that is implemented in one step."*

## **RULES AND OPEN GOVERNMENT COMMITTEE**

January 16, 2014

Subject: **RETIREMENT BOARD GOVERNANCE REFORM STRATEGIC WORKPLAN**

Page 2 of 4

Cortex's first recommendation in their report is to give the boards full permanent authority to hire, evaluate and terminate retirement services staff, etc. This may require a City Charter change through a ballot measure approved by the voters, which is discussed in more detail below. Ballot measures must be approved by Council 88 days before the election and the strict deadline must be followed to ensure placement on the ballot. This memo contains a workplan that indicates the timelines necessary for a ballot measure to be placed on the June 2014 ballot and the November 2014 ballot. Before the Council can take action on a ballot measure, certain action items need to be accomplished including stakeholder outreach, and development and analysis of policy alternatives.

### **BALLOT MEASURE DEADLINES**

The timeline below outlines the process for the City Council to approve a ballot measure:

<b>Ballot Measure Deadlines</b>		
<b>Action</b>	<b>June Election Deadlines</b>	<b>November Election Deadlines</b>
Workplan to Rules Committee	1/22/2014	1/22/2014
Last City Council meeting prior to 88 days before election	3/4/2014	6/17/2014
88 days before election	3/7/2014	8/8/2014

### **WORKPLAN TIMELINES**

The other key action items that would need to happen before a ballot measure or another policy alternative could proceed, in order of implementation with estimated timeframes, are:

1. Analysis and research of policy alternatives (14 days)
2. Presentation to Council of policy alternatives (1 Council meeting)
3. Stakeholder outreach (60 days)
4. Council consideration of alternatives and direction to staff (1 Council meeting)
5. Draft ballot measure and/or Municipal Code change (60 days)

In order to provide adequate time for the development of the ballot measure, it would be very difficult to meet each deadline in time for a June election. Therefore, the Council should consider placing the ballot on the November election, if the ballot measure alternative is the chosen method after all alternatives have been explored.

Using the key action items mentioned above, the specific timelines for the November election include:

RULES AND OPEN GOVERNMENT COMMITTEE

January 16, 2014

Subject: RETIREMENT BOARD GOVERNANCE REFORM STRATEGIC WORKPLAN

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Ballot Measure Deadlines	
Action	November Election Deadlines
Analysis and research of policy alternatives	2/5/2014
Presentation to Council of policy alternatives	2/11/2014
Stakeholder outreach	2/12/2014 – 4/14/2014
Council meeting to consider policy alternatives and provide direction to staff	3/18/2014
Draft ballot measure and/or Municipal Code change language	5/20/2014

### POLICY ALTERNATIVES

To accomplish the recommendations contained in Cortex's report, the City can explore different options (Please refer to the attachment for a summary of Cortex's recommendations.) The different issues to consider when deciding upon which option to take are legal issues, personnel issues and cost implications. The policy alternative determination will guide the City Administration's course of action. As part of the workplan, analysis will be done to determine if policy alternatives could address some or all of the recommendations contained in Cortex's report, short of a ballot measure. The development of the policy alternatives would also need sufficient time for the City Administration to consult with the City Attorney's Office and outside counsel.

### STAKEHOLDER OUTREACH

In 2009, the Cortex Phase I outreach that included two outreach meetings with the public, employees and retirees. These meetings were held on consecutive days with a total attendance of 212 individuals. The highest percentage of attendees was retirees. In anticipation of another large retiree turnout, it would be necessary to hold separate meetings for each of the stakeholder groups to encourage maximum participation. The stakeholder groups have been identified below:

- Bargaining units
- Retirees
- Active City employees
- General public
- Retirement boards

We anticipate that sixty (60) days will be needed to complete the stakeholder outreach due to the complexity of the issue and number of stakeholders. Additionally, after Council has approved the workplan, the City Administration will work to advertise the stakeholders meetings to the



RULES AND OPEN GOVERNMENT COMMITTEE

January 16, 2014

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requisite groups. The general public will be notified through emails to local businesses and neighborhood associations. Distribution of the stakeholder outreach meeting information will be communicated through email with an attached flyer noting the location and time of each meeting.

As part of the outreach, the two retirement boards were asked by Council to weigh-in on their support for the Cortex recommendations as a package. The two retirement boards are planning to discuss this topic in January 2014 and will provide the Council with their consensus after this meeting occurs.

**COST ESTIMATES**

Taking an issue to the ballot may result in substantial costs to the City depending on the number of items already appearing on the ballot. In conjunction with the City Clerk, the preliminary cost estimates for the June and November election can be found below:

Ballot Measure	June Election	November Election
Cost Estimate	Approximately \$425,000 - \$1,000,000	Approximately \$425,000- \$637,500

The funding source(s) for the ballot measure still need to be determined.

**CONCLUSION**

Although Cortex has specific recommendations, many details need to be determined. For example, it has not been discussed if all employees of Retirement Services or only executive level staff will be under the personnel authority of the retirement boards. The City Administration will develop policy alternatives and bring these alternatives back to Council for further consideration.



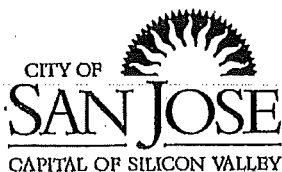
Alex Gurza  
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For questions, please contact Alex Gurza, Deputy City Manager, at (408) 535-8155.

Attachment

### Summary of Cortex Recommendations

Recommendation Category	Number	Recommendation
Expand the Authority of the Boards	1	Independence of the Boards <ul style="list-style-type: none"> <li>• Appoint, direct, evaluate and terminate staff</li> <li>• Set compensation levels and determine human resources policies</li> <li>• Appoint legal counsel</li> <li>• Establish procurement policies</li> </ul>
	2	All Board members selected by the City should be independent
Establish Additional Safeguards for Stakeholders	3	75% of the Board's composition should be independent
	4	Role of the Board's should be clearly defined in statute to exclude advocating or taking positions on legislative actions that affect the benefits provided by Retirement Services
	5	Discourage the Boards from engaging in economically targeted investing
	6	Staff serving the Retirement Boards should not be entitled to receive benefits from either System
	7	Any independent Board member appointed by the City or active/retired members should have expertise and experience relevant to the administration of the Retirement Systems
	8	Ability to offer appropriate compensation to independent board members (approximately \$20,000)
Transparency and Disclosure	9	Provide additional annual disclosures i.e. annual compensation for senior executives and independent report on the cost-effectiveness of the Systems
	10	Eliminate non-voting Board member
	11	Hold an annual general meeting that is accessible to the public
Sanctions	12	Enact provisions that allow for the removal of any Board member for their performance or conduct by appointing authorities
Risk Oversight	13	Conduct an external independent review of the Boards' fiduciary and management once every 5 years
	14	Establish an audit committee
Scale and Efficiency	15	Pursue consolidation of the two Systems under the oversight of one retirement board



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Approved

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January 16, 2014

**Subject: RETIREMENT BOARD GOVERNANCE REFORM STRATEGIC WORKPLAN**

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